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DIRECTORATE OF
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SECRET

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18 July 1972

Central Intelligence Bulletin

CONTENTS

CHILE: The government's by-election win could add to growing political tensions. (Page 1)

USSR-CHILE: Moscow offers long-term credits. (Page 2)

URUGUAY: Tupamaro deal with the government turned down. (Page 3)

THE NETHERLANDS: The government loses its parliamentary majority. (Page 4)

MEXICO-US: Interim agreement on salinity. (Page 5)

VIETNAM: Situation report (Page 7)

LAOS: Road improvements (Page 7)

EGYPT-USSR: T-62 tanks (Page 9)

CEYLON-CHINA: Disappointment over loan (Page 9)

CARIBBEAN: Economic cooperation with EC (Page 10)

INTERNATIONAL MONETARY DEVELOPMENTS: Finance ministers meeting (Page 10)

MBFR: Caution Among the Allies. (Page 11)

SECRET

SECRET

CHILE: The government's victory in the Coquimbo by-election could add to growing political tensions.

The Communist candidate won the legislative contest on 16 July, replacing a deceased fellow party member. Her margin of victory was smaller than that won by the government in recent elections in that province, but even the combined opposition was unable to defeat the Popular Unity (UP) coalition as it had in the three other legislative by-elections since Allende took power.

In counting the votes for the even more important election for leadership of the trade union confederation, the results of which were announced this weekend, the Communists and Socialists suppressed their differences to overcome an unexpectedly strong challenge from the Christian Democrats. There seems little question, however, that some manipulation of votes was involved in the seven-week-long count that gave the Socialists a slim margin over the Christian Democrats and enabled a Socialist to retain the position of secretary-general.

These victories, plus those in two university elections, are encouraging the coalition to strengthen its attacks on the opposition. President Allende and the Communists have adopted the Socialists' more aggressive mood since the recent breakdown of their compromise discussions with the Christian Democrats. The UP is stirring up public demonstrations against the congressional opposition's impeachment proceedings against the interior minister and its overriding of Allende's vetoes of recent legislation. Pro-government demonstrators disrupted the work of the Supreme Court and the congress last week. [REDACTED]

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25X1

18 Jul 72

Central Intelligence Bulletin

1

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USSR-CHILE: Moscow has offered Santiago \$260 million in long-term credits for the purchase of machinery and other capital equipment. An additional \$40 to 50 million has been provided by the USSR and East European countries to finance current commercial operations, according to the Chilean press.

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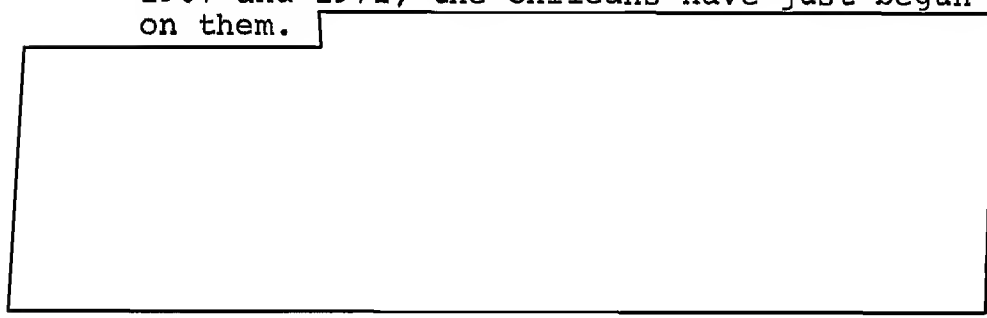
Announcement of the new credits follows by only a month the formal conclusion of a \$65-million credit from China. The new assistance represents substantial and continuing Soviet support for both the Allende government and the hard-pressed Chilean economy.

The new credit offer was made public shortly after the return from Moscow of a Chilean delegation that concluded several economic agreements that had been earlier discussed in Chile. It indicates that Moscow has made a thorough evaluation of the political and economic situation in Chile. Important measures designed to expand trade apparently also were signed during the Moscow visit.

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Moscow's previous assistance to Chile has been limited to a \$50-million short-term hard currency credit and two long-term credits totaling \$97 million for project assistance and machinery exports. Although the latter two credits were provided in 1967 and 1971, the Chileans have just begun to draw on them.

25X1



18 Jul 72

Central Intelligence Bulletin

2

SECRET

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URUGUAY: The Tupamaros reportedly have tried to make a deal with the military and have been turned down.

25X1 [redacted] Tupamaro leaders last week offered to suspend activities for an unspecified period of time if the armed forces would seize control of the government and jail "villainous politicians and oligarchs." Although these terms were clearly unacceptable to the military, the Tupamaros may be attempting to play on recent dissatisfaction within the armed forces over congressional criticism of counterterrorism. A group of irate army officers has issued a proclamation stating that "any action that tends to defame conduct by members of the armed forces in their struggle against subversion is treason."

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25X1 The Tupamaros are obviously in need of a respite after their losses of the past three months. They may have decided to try a different approach to their stated objective of forcing a military coup d'etat, which they see as the next stage in the revolutionary process.

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[redacted]

18 Jul 72

Central Intelligence Bulletin

3

SECRET

SECRET

THE NETHERLANDS: With the resignation of two cabinet ministers the Biesheuvel government has lost its parliamentary majority. The result could be early national elections.

244

Disagreement within the fragile five-party coalition over an expected billion-dollar deficit in next year's budget figured in the latest development. The cabinet had been trying since 11 July to reach a compromise. These attempts failed and Minister of Waterways Drees and Minister of Higher Education de Brauw, both members of the small but pivotal Democratic Socialist Party, resigned yesterday.

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Drees and de Brauw claim that economies introduced in the budget by Biesheuvel have left them with insufficient funds to run their ministries, but they also have a broader and somewhat contradictory complaint. Democratic Socialists, who advocate stringent anti-inflation measures, have long been frustrated by the cabinet's refusal to adopt their recommendations, particularly the institution of wage and price controls.

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With the defection of eight Democratic Socialists, the government's strength in the 150-member parliament now stands at 74. Biesheuvel may try to appease Drees and de Brauw by renegotiating the all-party agreement on economic policy drafted a year ago. If Biesheuvel cannot get the Social Democrats back, the rump coalition could limp along as a minority government. Interparty disagreement on other issues, however, is growing. The Liberals, like the Democratic Socialists, are disturbed about the leftward trend and leadership in the Catholic People's Party. Defection of the Liberals would prompt Biesheuvel to call elections before parliament reconvenes this September.

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MEXICO-US: The interim agreement to reduce the salinity of Colorado River waters delivered to Mexico should alleviate pressures on President Echeverria from powerful agrarian interests in the Mexicali Valley.

142

Farmers in the valley have long complained that US irrigation systems have washed so much salt out of the soil that the water reaching Mexico is far more saline than they are willing to accept under a treaty signed by the two countries in 1944. Effective immediately, the US is diverting over half of the relatively saltier drainage from the Wellton-Mohawk irrigation project that flows into the Colorado River and replacing it with better quality water. This arrangement will satisfy Mexico until the end of this year, at which time a definitive solution will have to be found or the present interim agreement extended.

142

Several temporary measures have been adopted during the past decade but all efforts to reach a permanent settlement have failed; Mexico's Foreign Ministry has often threatened to resort to third-party settlement. Echeverria has thus far rejected this approach, preferring to solve the problem bilaterally. The interim agreement and the designation of a special US representative to study the matter and submit proposals by year's end for a permanent solution have led to optimism on both sides that an agreement can be achieved this time. The solving of this principal bilateral irritant would considerably enhance Echeverria's political reputation. His visit to the US was widely acclaimed in the Mexican media as a success and he undoubtedly wants to keep this image alive.

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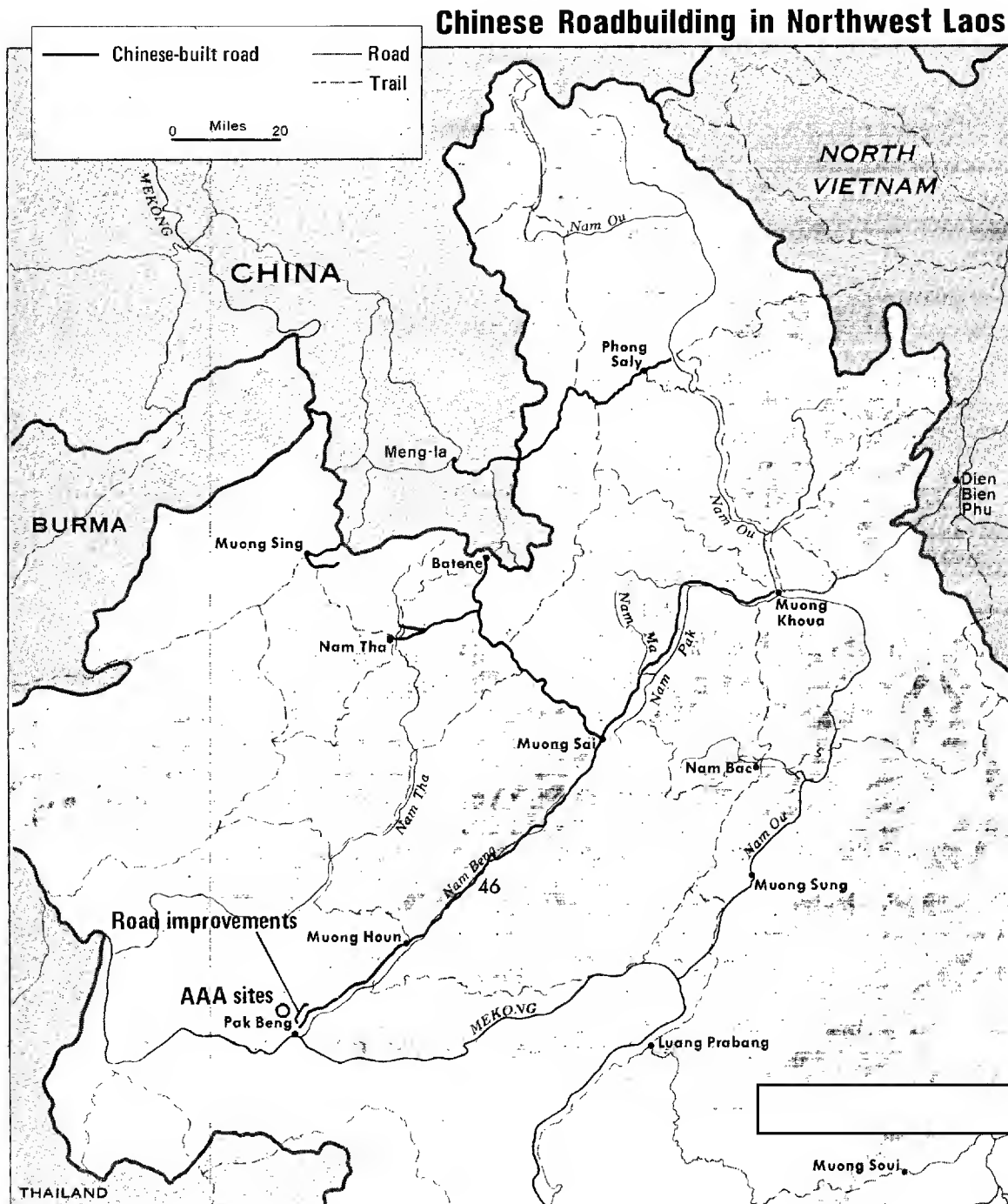
18 Jul 72

Central Intelligence Bulletin

5

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VIETNAM: The heavy fighting around Quang Tri City has temporarily subsided, but both sides appear to be preparing for a sustained contest throughout the area. Only small clashes northeast and south of the provincial capital have been reported since the weekend, presumably because government forces currently are trying to consolidate their positions and push deeper into the province rather than merely effect a rapid recapture of Quang Tri City. The Communists are relying primarily on intensive artillery and mortar fire to slow the government drive, directing almost 1,000 rounds at government positions on 16 July alone.

[REDACTED]

LAOS: The Chinese are making improvements to Route 46 between Muong Houn and Pak Beng during the current rainy season. According to photography of 8 July, they are building bridges, and widening and realigning the road, and they have built three anti-aircraft weapons sites on the hills outside of Pak Beng. There is no evidence that the Chinese are preparing at this time to extend their roadnet into the Nam Ou River Valley, where some survey work took place earlier this year. No appreciable progress was noted on the other major road construction project between Muong Sing near the Sino-Laotian border and Nam Tha.

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18 Jul 72

Central Intelligence Bulletin

7

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T-62 Medium Tank

Photograph of model



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|----------------|----------------------|
| First observed | 1961 |
| Main armament | 115mm smoothbore gun |
| Weight | 40.2 tons |
| Speed | 30 mph |
| Cruising range | 310 miles |
| Crew | 4 |

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EGYPT-USSR: Cairo has received a second shipment of T-62 tanks from the USSR, indicating Moscow's willingness to meet some of President Sadat's requests for continued modernization of the military establishment. Thirty T-62s were unloaded in Alexandria in late May [REDACTED]

[REDACTED] At least ten T-62s, the first delivered outside the Warsaw Pact, arrived in Egypt earlier in the year. These tanks are more advanced and carry a more powerful gun than the T-55s that now make up the bulk of Egypt's armor. [REDACTED]

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CEYLON-CHINA: Ceylonese officials are disappointed that a recent \$52-million loan commitment from China does not provide for any hard currency. Earlier reports indicated that China had offered a hard currency credit of at least \$25 million, matching a credit extended last year. Although Peking is expected to make additional hard currency available, rumors place the amount as low as \$5 million. The finance minister says that the Chinese aid will not be enough to meet the country's immediate budgetary problems and that the government will have to adopt measures to reduce fast rising government-subsidized food consumption expenditures, the crux of Ceylon's problems. Such reform measures are politically unpopular, however, and despite urgings from the Western Aid Consortium, Colombo so far has been reluctant to act. [REDACTED]

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18 Jul 72

Central Intelligence Bulletin

9

SECRET

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CARIBBEAN: Twelve Commonwealth Caribbean governments have agreed to seek a group arrangement with the enlarged European Communities (EC) to protect their exports, which would otherwise suffer as Commonwealth preferences are phased out. This decision was reached at the Caribbean Free Trade Association meeting held in Dominica, 10-13 July. The group approach offers the participants--the four independent nations of Barbados, Guyana, Jamaica, and Trinidad and Tobago, six associated states, and two colonies--the best prospects in negotiations with the EC. Effective joint bargaining for preferential trade arrangements could stimulate additional economic cooperation.

[REDACTED]

INTERNATIONAL MONETARY DEVELOPMENTS: The two-day meeting of finance ministers of the Ten that began in London yesterday had a moderating effect on the currency markets. Although the dollar closed at or near the floor on all major exchanges, officials described intervention buying as "moderate" compared with "extremely heavy" last Friday. The effect on the market was presumably due to the ministers' affirmation that no new decisions are expected that will alter the present measures now in force. European central banks have purchased the equivalent of \$2 billion in the last week to keep their currencies within the levels prescribed by international agreement.

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18 Jul 72

Central Intelligence Bulletin

10

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SECRET

MUTUAL AND BALANCED FORCE REDUCTIONS (MBFR)

Recent discussions among the NATO allies on how to initiate talks with the East on MBFR have highlighted the difficulty of reconciling their disparate interests into a coherent NATO position. US suggestions on who should participate in the force reduction talks and how they should be organized have been sharply questioned by the allies. Although in part a reflection of the very real procedural problems involved, their reaction reflects deeper concerns about the impact that force reductions might have on European security interests.

Since the Soviet agreement during the Moscow summit to join in force reduction talks while preparing for a Conference on Security and Cooperation in Europe (CSCE), the allies have become even more cautious. All but France are prepared to move toward negotiations, but they prefer that actual reductions be delayed as long as possible. This sentiment translates into general support for West Germany's phased approach that envisions reductions only at the end of a lengthy process. The British have long urged circumspection, while the French continue to boycott force reduction planning.

Despite US reassurances, many of the allies are nervous about US intentions. West German disarmament commissioner Roth complained only last week that, whereas Bonn approached MBFR as part of its broader Ostpolitik, he remains uncertain what the US wants out of MBFR other than a vehicle to combat domestic pressures for a reduction of US forces in Europe. The director of political affairs in Rome's foreign office, noting Italy's lack of enthusiasm for MBFR, portrays it as a "fig leaf" for US and West German force reductions.

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18 Jul 72

Central Intelligence Bulletin

11

SECRET

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The most immediate question facing the allies is how to get the preliminary soundings with the Soviet side under way. Since the summit meeting, Soviet officials have made clear their preference that the necessary arrangements be made bilaterally with the US, although Soviet Foreign Minister Gromyko reportedly suggested to the West Germans that two or three Western allies might contact the Soviets as well. Moscow apparently expects the West to make the next move, and it will probably agree to any procedure that does not have a bloc-to-bloc cast and keeps MBFR sufficiently separate from the CSCE.

An even more difficult problem for NATO will be how to accommodate the views of allies who might not participate directly in any eventual negotiations. The UK, FRG, and a few other allies agree with the US that only those allies and Warsaw Pact states with forces or territory involved should participate. This would include the US, UK, FRG, Canada, Belgium, the Netherlands, and Luxembourg on the Western side, and the USSR, East Germany, Poland, Czechoslovakia, and possibly Hungary on the East. The Italians, joined by the other allies on the northern and southern flanks, nevertheless continue to press for representation in the exploratory talks.

Italy and some other allies have also been attempting to link MBFR to a CSCE so that they may make known their views on force reductions at the security conference. Most allies sympathize with the Italians in principle and are willing to establish at least minimal links between CSCE and MBFR. They all favor discussion at a security conference of confidence-building measures, such as advance notification of maneuvers and exchanges of observers. Since such measures will also be considered during MBFR talks, this would provide a substantive link between CSCE and MBFR. The Italians, again supported by a number of other allies, may also press for a declaration of general principles on force reductions at a CSCE.

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18 Jul 72

Central Intelligence Bulletin

12

SECRET

SECRET

The desire of the allies to accommodate the interests of their partners on the flanks and their expectation that the Soviets will continue to promote US-USSR bilateralism on MBFR led to criticism of the US proposals for organizing the force reduction talks in the North Atlantic Council (NAC) last week. The US would locate the MBFR explorations in Geneva. Most allies, however, want the MBFR talks in the same place as the CSCE preparations and at the same time. These are expected to begin in Helsinki late this year.

The allies also are strongly negative about the US formula for conducting the talks. The US would have the NAC focus on general objectives and strategies while a more limited group of allies actually conducted the explorations. An ad hoc group open to all allies would consult at the site of the talks but would not direct the negotiating team. Most allies feel that this arrangement would not take sufficient account of the interests of non-participants. They appear to favor a Canadian proposal that a force reduction "policy board" open to all allies be established in Brussels. A smaller group would conduct the explorations, receiving guidance from the board.

Despite more than two years of study and debate within the alliance, many substantive aspects of MBFR remain in dispute. For example, the allies do not have established positions on such basic questions as the relationship between reductions of foreign and indigenous forces, what to do with the equipment of reduced units, and how to deal with tactical nuclear weapons and their delivery systems. With explorations not far away, the allies will have to work at an uncommonly rapid pace to get their ducks in a row. A number of allies, particularly

18 Jul 72

Central Intelligence Bulletin

13

SECRET

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the FRG, are pressing for an early revision of the "Brosio mandate" that was prepared last fall to guide the abortive MBFR mission to Moscow of former NATO secretary-general Brosio. This question will be addressed in the NAC tomorrow, as will the US and Canadian proposals for exploratory talks. [REDACTED]

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25X1

25X1

18 Jul 72

Central Intelligence Bulletin

14

SECRET

Secret

Secret